

***United States Court of Appeals
for the Second Circuit***



**APPELLEE'S REPLY
BRIEF**

77-1342

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-1342

UNITED STATES OF AMERICA,

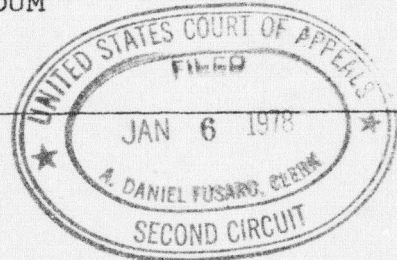
Appellant,

v.

DOUGLAS P. FIELDS, FREDERICK M. FRIEDMAN, PETER S.
DAVIS, ALAN E. SANDBERG, and ERIC BERGE,

Defendants-Appellees.

DEFENDANT-APPELLEE ALAN E. SANDBERG'S
BRIEF IN RESPONSE TO THE MEMORANDUM
OF THE SECURITIES AND EXCHANGE
COMMISSION, AMICUS CURIAE



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Preliminary Statement

This memorandum replies to the memorandum of the Securities and Exchange Commission ("SEC"), Amicus Curiae, filed pursuant to a letter of the Panel dated November 22, 1977, which requested the SEC to describe the criminal reference procedure, formal and informal, which was in effect during the period involved in this case.

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Attorney for the Southern District, certain information concerning the TDA investigation and recommending it for prosecution. These communications were initiated by the SEC staff attorney and were not previously authorized by the Commission, the SEC General Counsel, or the Director of the Division of Enforcement.

Finally, on December 1, 1975, another SEC attorney communicated with another Assistant United States Attorney concerning the SEC's TDA investigation and sent copies of the pleadings in SEC v. TDA, et al. to the United States Attorney's office, and thereafter the investigative file. This contact was also initiated by the SEC staff attorney and lacked the approval of the Commission, the SEC General Counsel or the Director of the Division of Enforcement. Indeed, it was not until April 25, 1977, after the appellees attacked the legitimacy of the SEC criminal reference at the hearing below that the Commission purported to approve that reference, nunc pro tunc.

Based on these facts, the principal issue posed by appellee Sandberg is whether the criminal reference here was invalid because it was not approved by the Commission. The SEC apparently seeks to obfuscate

this issue by creating and attacking arguments which were never even advanced by appellee Sandberg. Contrary to the SEC's suggestions, appellee Sandberg does not question either the authority of the Department of Justice to decide whether to prosecute a criminal case (SEC Brief at 12), or the validity of an informal criminal reference after Commission approval has been given (see SEC Mem. at 10).^{*} Furthermore, appellee Sandberg does not here quarrel with the informal criminal reference procedure described by the SEC (SEC Mem. at 11), and also does not contend that the regulations mandate the preparation of a written criminal reference report in every case (see SEC Mem. at 11-12).^{**} However, the relevant statutes, rules and

^{*}There appears to be some confusion as to the meaning of the term "informal criminal reference". As used in appellee Sandberg's original brief it was intended to describe the procedure actually employed in this case, i.e., the transmission by an SEC attorney to the office of the United States Attorney of information concerning a matter which is the subject of a Commission formal order of investigation, with a recommendation that the case be prosecuted criminally, without the prior approval of the Commission.

^{**}In passing, we should note the SEC, during the period involved (1975), specifically advised the Congress to the contrary. It stated that references were always in writing, approved by persons of increasing authority and then by the Commission itself (App. 207-08; 248-49).

regulations clearly do require that all criminal references, whatever form they take, must first be approved by the Commission after they are reviewed by the SEC General Counsel and by the SEC Director of the Division of Enforcement. Significantly, the SEC has conceded the correctness of this essential point stating (see SEC Mem. at 10):

"A criminal reference may assume two principal forms ... but, in either event, it is authorized by the Commission." (citations omitted)

While the SEC agrees with appellee Sandberg that all criminal references must be approved by the Commission,* it apparently seeks to avoid the necessary

*Neither the SEC nor the Government has contended, and with good reason, that the Commission's nunc pro tunc approval on April 25, 1977 of the criminal reference constitutes a valid approval. The requirement of Commission approval would be meaningless if it could be satisfied by Commission ratification of a completed reference. Moreover, the criminal reference form signed by the Commissioners (Def. Ex. AK; App. 295-96) does not admit of a retrospective ratification. The language of the form is prospective to the effect that the Commission granted future access to the files, not approval of access already gained.

implication of such a rule in this case by apparently suggesting that no criminal reference occurred here. Apparently it is the SEC's General Counsel's view that "preliminary communications" between the SEC staff and the office of the United States Attorney, in which SEC pleadings or filings are provided to the latter and in which the SEC attorneys provide "a basic outline of the relevant facts and materials adduced during a pending Commission investigation" (SEC Mem. at 9-10), do not constitute a criminal reference which requires Commission approval (SEC Mem. at 11, n.28). Rather, a criminal reference is made only when the Commission transmits or makes available to the United States Attorney's office the SEC's investigative file on a particular matter (SEC Mem. at 10-11).

Respectfully, this argument gratuitously proffered here for the first time should be rejected because it is inconsistent with the Government's prior position regarding the meaning and timing of this criminal reference and is, in any event, totally without merit.

Discussion

THE CONDUCT OF THE SEC ATTORNEYS IN THE FALL OF 1975 CONSTITUTED AN INVALID CRIMINAL REFERENCE REQUIRING DISMISSAL OF THE RESULTING INDICTMENT

A. There Is No Support For The SEC's Narrow Construction of a Criminal Reference

The SEC's Procrustean definition of "preliminary communications" is artifically tailored to the facts in this case. Nowhere before today has the SEC defined or even suggested that such "preliminary communications" by staff attorneys with the United States Attorney's office are permitted without Commission approval. We respectfully submit it is absurd for the SEC to argue that an SEC staff attorney, who may be fresh out of law school, is authorized by an unpublished policy to convey to the United States Attorney's office virtually all of information contained in an SEC investigative file, but the Commission, under published regulations, must authorize the physical transmission of that same file to the prosecutor.* If by making a criminal reference the

*Under the SEC's newly discovered policy, a staff attorney who has prepared a formal written criminal reference report could, before forwarding the report to the General Counsel and Director of Enforcement for review and before obtaining the approval of the Commission, properly read the report in its entirety to an Assistant United States Attorney under the guise of "preliminary communications". Respectfully, under these circumstances the subsequent approval, or even disapproval, by the Commission of the criminal reference would be a meaningless exercise.

Commission is merely authorizing the physical transmission of its investigative file, we are unable to comprehend what conceivable consultative function is to be performed by the SEC General Counsel and the Director of the Division of Enforcement. We submit that more is contemplated in the making by the Commission of a criminal reference than the logistical determination of how to ship an investigative file to the United States Attorney's office. It is the Commission which must decide whether the case shall be referred for criminal prosecution. However, under the SEC's new policy that question is answered the moment the SEC staff attorney communicates with the United States Attorney concerning the case. As a practical matter we do not believe the Commissioners would refuse to send a file which is requested by the United States Attorney in response to a "preliminary communication".

Of course, even if the SEC's narrow interpretation of a criminal reference were correct, the conceded requirement of Commission approval was not satisfied in this case, for the SEC transmitted its investigative file to the United States Attorney long before the Commission's purported nunc pro tunc approval on April 25, 1977 (see App. 194-95).

However, the SEC's contention that there exists a sub species of criminal reference called "preliminary communications", which does not require Commission approval, is wholly without foundation. Indeed, the only authority cited for this policy is the testimony of Messrs. Stanley Sporkin and John R. Wing (SEC Mem. at 9, nn. 22-25). This dearth of support should of itself cast doubt as to the correctness of the SEC's position particularly when it is compared with the substantial statutory and regulatory authority cited in support of every other Commission practice or policy referred to in the SEC's memorandum (see SEC Mem. at 6-8, nn. 13-17, 20).

Not only is there no authority for the SEC's so-called policy of "preliminary communications" without prior approval of the Commission, such communications are prohibited by the applicable regulation, 17 C.F.R. §230.122. In brief, 17 C.F.R. §230.122 provides that "information ... 'obtained by officers or employees of the Commission ... [is] confidential', and it prohibits the disclosure by officers and employees "of such confidential information ... to anyone ... unless the Commission authorizes the disclosure" (emphasis supplied).

Neither that regulation nor any other we have found, defines or in any way attempts to qualify the type of "information" embraced by it. Applying the test of every day usage, the term "information" must include the information which the SEC says may be transmitted in "preliminary communication", such as "a basic outline of the relevant facts and materials adduced during a pending Commission investigation" (see SEC Mem. at 10). Clearly such information is confidential within the meaning of C.F.R. §230.122, and we do not believe that it becomes less confidential if it is disclosed during "preliminary communications" as opposed to some other more formal (or perhaps informal) mode of communication.

As the SEC has conceded (SEC Mem. at 10), Section 171 of the SEC Manual of Administrative Regulations entitled "Cooperation With Federal, State, and Foreign Government Authorities and With Self-Regulatory Organizations" was intended to carve out a series of exceptions to the prohibition against disclosure set forth in 17 C.F.R. §230.122. However, none of the exceptions is applicable to this case principally because at the time the "preliminary communications" occurred here, the TDA matter was the subject of a Commission

formal order of investigation. Accordingly, under SEC Manual, Section 171.08, the staff could only "recommend to the Commission that the information be turned over to [other Federal or State authorities]." The staff had no authority on its own to turn this information to the United States Attorney without the prior approval of the Commission.

No good reason is advanced by the SEC as to why obtaining prior approval from the Commission before "preliminary communications" are made by staff attorneys would necessarily create statute of limitation problems or unreasonable delays in violation of defendant's Sixth Amendment rights to a speedy trial (see SEC Mem. at 8-9). Certainly the Commission is capable of acting with dispatch, as it did during the hearing in this case when the Government realized it had not obtained Commission approval.

Significantly, the SEC's argument that "the policy of encouraging early exchanges of information is beneficial, not only for the purpose of administrative efficiency, but also to protect the rights of potential criminal defendants" (SEC Mem. at 9), underscores the correctness of an argument which appellee Sandberg has

voiced repeatedly, i.e., that rules and regulations governing the division of authority and responsibility within a Government agency necessarily implicate the individual rights of the persons who are the subject of the administrative action involved. Here the regulations requiring Commission approval of a criminal reference are more than mere housekeeping arrangements. They were clearly intended to protect the individual rights of the persons who are the subject of the reference (see Sandberg Br. at 17-18, 26, n.). Moreover, under the Acardi doctrine it is not even necessary to show that the regulations were intended to confer procedural rights on the individual. All that need be shown is that the agency has failed to exercise a duty or discretion which promulgated regulations require of it (see cases cited in Sandberg Br. at 20-31).

The SEC makes the further argument that informal unauthorized communications by SEC staff personnel to the United States Attorneys will obviate difficulties in coordinating the timing of criminal and civil proceedings. Respectfully, this contention is refuted by the very facts in this case. As we have previously argued (Sandberg Br. at 17-18), if the

regulations had been followed here, the proposed criminal reference would have been reviewed by Stanley Sporkin, the current Director of the Division of Enforcement (see 17 C.F.R. §200.19b). At the hearing below, Mr. Sporkin testified that if he had known of the proposed criminal reference, he would, under the facts presented, at least have disabused defendants' counsel of any thought that settling the civil case would conclude the criminal case (Tr. 768-69). Mr. Sporkin felt that in fairness such disclosure should have been made. It is precisely for this reason that, while the regulations may not require disclosure of the fact of a criminal reference, they do require that persons with Mr. Sporkin's experience, judgment and high position, rather than young inexperienced staff attorneys, should be the ones to decide whether a criminal reference shall be made, and if so, what disclosure of salient facts (the reference) are appropriate in the circumstances.

Finally, the SEC's so-called policy of "preliminary communication" is inconsistent with its own prior pronouncements concerning the SEC's relationship with the Department of Justice and specifically how it

initiates a criminal action. Those pronouncements, made during the time this case was referred (see Def. Ex. AB; App. 207-08; Def. Ex. AE; App. 239-87), say nothing concerning this so-called long-standing policy. Indeed, the SEC has taken the public position that only individuals "of increasing experience and authority" should make the critical policy judgments as to "whether proposed defendants should be added or deleted and whether further pursuit of this [criminal reference] report should be made at all" (App. 248-49).

In short, however desirable the SEC believes its policy of "preliminary communications" may be, it is not authorized, indeed it is prohibited, by the applicable rules and regulations of the Commission.

B. The SEC's Narrow Construction of a Criminal Reference is Contrary to the Position Previously Taken By The Government in This Case

Assuming, arguendo, that there is some merit to the SEC's position that so-called "preliminary communications" do not constitute a criminal reference, the argument must be disregarded here on the grounds of judicial estoppel. The Government cannot take a position now which is totally inconsistent with its prior position as to when the criminal reference was made in this case. See, Director General of India Supply Mission v. S.S. Maru, 459 F.2d 1370, 1377 (2d Cir. 1972), cert. denied, 409 U.S. 1115 (1973); National Utility Services Inc. v. Whirlpool Corp., 325 F.2d 779 (2d Cir. 1963); In Re Johnson, 518 F.2d 246, 252 (10th Cir.), cert. denied, 423 U.S. 893 (1975); A. Duda & Sons Cooperative Ass'n v. United States, 504 F.2d 970, 975 (5th Cir. 1974) and cases cited therein; 1 B J. Moore, Federal Practice, ¶405[8].

At the commencement of the hearing below, the first question considered by Judge Haight was whether a criminal reference occurred, and if so, when. The Assistant United States Attorney stated unequivocally

that the existence of a criminal reference was not an issue in this case. Indeed, he stipulated that on December 1, 1975, the SEC brought to the attention of the office of the United States Attorney the facts concerning the case of SEC v. TDA Industries, et al. and that this conveyance of information constituted a criminal reference (App. 297-99). The colloquy between the Court and the Assistant United States Attorney concluded as follows (App. 299):

"THE COURT: And I need not concern myself with semantic subtleties as to whether or not what took place was a 'criminal reference', you make no point on that?

"MR. CUTNER: I do not."

Moreover, in its original brief to this Court, the Government conceded that what transpired in September, October and November, 1975 constituted a criminal reference, albeit an "informal" one. The Government's brief states as follows (Gov't Br. at 10):

"Meanwhile, in September, October, and November, 1975, the same SEC attorney had called the United States Attorney's Office and informally suggested a criminal prosecution as soon as the civil case was completed, and on December 1, 1975, the SEC forwarded to the United States Attorney's Office copies of the papers filed in the civil case. (App. 55-56, 205)."

In the accompanying footnote, the Government clearly takes the position that these events, which the SEC now attempts to characterize as "preliminary communications", constituted an informal criminal reference. As in A. Duda & Sons Cooperative Ass'n v. United States, supra, 504 F.2d at 975, the Government through the SEC is seeking to espouse a defense "that it abjured by stipulation below." In such circumstances the Court is bound to enforce the stipulation "even if the government is the party bound." Id.

In reliance upon the Government's stipulation and the other evidence presented, Judge Haight found that an informal criminal reference occurred on December 1, 1975 (see Findings of Fact, ¶¶33, 34, 35; App. 56-58). While Judge Haight declined to hold that the unapproved informal reference was invalid* there was no question in his mind that it had occurred. He found (Opinion at 34, App. 68-69):

"In the case at bar, it is undisputed that the criminal reference took the form of an informal advice from Tucker of the SEC to Wing of the United States Attorney's Office." (emphasis supplied)

*The SEC in its Amicus brief disagrees with Judge Haight's conclusion that "[n]othing in the statute or regulations expressly prohibits any method of criminal reference other than a reference by the Commissioner's themselves" (Decision at 35; App. 69). Quite to the contrary the SEC agrees with appellee Sandberg that "[A] criminal reference may assume two principal forms [formal and informal] but, in either event, it is authorized by the Commission" (SEC Mem. at 10) (emphasis supplied).

The Government (or the SEC) cannot now complain that this determination of Judge Haight was in error for it was clearly induced by the Government's position below. See, Director General of India Supply Mission v. S.S. Maru, supra, 459 F.2d at 1377.

Respectfully, on this appeal the Government is bound by its previous concession and Judge Haight's finding that a criminal reference was made on December 1, 1975. That fact coupled with the SEC's unequivocal position that all criminal references must be approved by the Commission, leads ineluctably to the conclusion that the criminal reference here was invalid.

Conclusion

For the foregoing reasons and for the reasons set forth in the original briefs submitted on behalf of appellee Sandberg and for the reasons set forth in the briefs of the other appellees which are applicable to appellee Sandberg and which he joins, it is respectfully submitted that the District Court's order dismissing the indictment should be in all respects affirmed.

Dated: January 5, 1978

Respectfully submitted,

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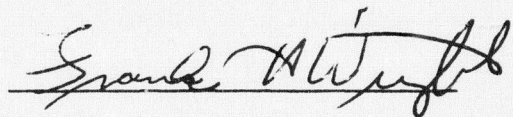
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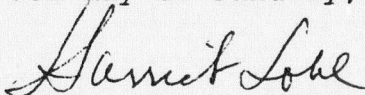
CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing Brief have been served by hand on Lawrence B. Pedowitz, Esq., Assistant United States Attorney, One St. Andrew's Plaza, New York, N.Y., attorney for appellant; and by mail on Bender & Frankel, Esqs., 225 Broadway, New York, N.Y. 10007, attorneys for defendants-appellees Douglas P. Fields and Frederick M. Friedman; Orans, Elsen & Polstein, Esqs., One Rockefeller Plaza, New York, N.Y. 10020, attorneys for defendant-appellee, Peter S. Davis; Howard Wilson, Esq., c/o Hochman, Salkin and DeRoy, 9100 Wilshire Blvd., Los Angeles, California 90212, attorney for defendant-appellee Eric Berge, and Securities and Exchange Commission, Office of the General Counsel, 500 North Capitol Street, Washington, D.C. 20549, all on the 6th of January, 1978.



Frank H. Wright

Sworn to before me this
6th day of January, 1978.



Notary Public

HARRIET LOBL
Notary Public, State of New York
No. 03-7578060
Qualified in Bronx County
Certificate filed in New York County
Commission Expires March 30, 1979